

Good Bad Press: Observations and Speculations About Internal Revenue Service Accountant- Informants

"[Y]eah, I'm the taxman.
And you're working for no one but me."

THE BEATLES, *Taxman*, on REVOLVER (EMI Records 1966).

I. CHECKMATE, ACCOUNTANT TO TWO MASTERS

It was February, 1982. In the course of his duties Eagle, an Internal Revenue Service agent, heard from an informant named Magpie. According to Magpie, a St. Louis restaurateur, Rook, was moonlighting as a magician: he was making gross income disappear.¹

Eagle eyed Rook's returns. They had been prepared by Checkmate,² a Missouri-licensed certified public accountant. Checkmate had once helped Eagle by spilling the beans on some nefarious tax shelter promoters.³ Since then, Eagle had known Checkmate by the cryptic code name "controlled informant number 43,111."⁴

In May 1982, Eagle rendezvoused with Checkmate to make a payoff for promoter information. The thrifty Eagle seized the opportunity to pump Checkmate for some information on revenue-skimming in the local restaurant industry. At first, Checkmate refused to talk. Later, however, he cracked, grudgingly admitting that he had prepared returns for Rook.⁵

Rook had been a fertile source of carrots for Checkmate, paying him over fifty thousand dollars for preparing returns and handling business records throughout the 1980s.⁶ But Checkmate feared the big stick of the Internal

¹ As the reader may surmise, "Eagle," "Magpie," and "Rook" are aliases used for expository purposes. For the true identities of Eagle and Rook, see Tim Bryant, *A Private Accountant? CPA Helps IRS Gain Evidence Against Client*, ST. LOUIS POST DISPATCH, June 12, 1989, at 1B.

² "Checkmate" is also an alias. See *id.* His real-life counterpart is now deceased. See William L. Raby, *An Absence of Privilege—The Big Chill?*, 53 TAX NOTES 451, 451 (Oct. 28, 1991).

³ Bryant, *supra* note 1. Checkmate was ultimately paid for his help, but his cooperation with the Service was motivated less by bounty than by a federal tax lien: Checkmate was delinquent in his taxes some \$20,000. *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

Revenue Service; even though he was representing Rook in a civil tax audit,⁷ Checkmate began feeding information about Rook's finances to the open-mouthed Eagle.⁸ By conveying this information, Checkmate violated both rules of professional conduct and state law.⁹

After hearing Checkmate's pilfered information, a federal grand jury indicted Rook on charges of income tax evasion and signing false corporate tax returns.¹⁰ Eagle's victory, however, took flight: despite winning a ruling that Missouri's accountant-client privilege statute could not be used to suppress the incriminating evidence,¹¹ attorneys for the Department of Justice, following a stern rebuke from the magistrate, unexpectedly dropped the case.¹² The outcome for Checkmate was hardly better. For his valiant efforts on behalf of the United States Treasury, state authorities stripped him of his license to practice public accounting.¹³

The preceding tale of the "IRS rat fink" exploded across the front page of the *Wall Street Journal* in February of 1990.¹⁴ The *Journal's* editors, sensing an opportunity, undoubtedly believed their coverage would cause accountants and lawyers, respectively, to perspire and salivate. Their beliefs were vindicated; the story reached, and raised the pulse of, many people. The story reached the issues, however, tangentially if at all. It focused so sharply on the deception that it missed the background: another hard policy choice between anarchy and the police-state. The government cannot operate without an effectively enforced tax system, but Americans abhor overzealous law

⁷ Certified public accountants may practice before the Internal Revenue Service. See MICHAEL I. SALTZMAN, *IRS PRACTICE AND PROCEDURE* 1-61 (1981).

⁸ Bryant, *supra* note 1.

⁹ See *infra* notes 22, 25 and accompanying text.

¹⁰ Lee Berton, *Tax Nightmares: IRS Target Finds His Accountant Was U.S. Mole*, WALL ST. J., Feb. 22, 1990, at A1; Tim Bryant, *Chesterfield Man Charged in Tax Case*, ST. LOUIS POST DISPATCH, Mar. 15, 1989, at 7B.

¹¹ Tim Bryant, *U.S. Magistrate Denies Bid For Confidentiality*, ST. LOUIS POST DISPATCH, Jan. 25, 1990, at 11A.

¹² Milo Geyelan and Ellen Joan Pollack, *U.S. Drops Accountant-Informant Case*, WALL ST. J., Nov. 25, 1991, at B6; Tim Bryant, *U.S. Drops Case Built on Accountant-Informant*, ST. LOUIS POST DISPATCH, Nov. 23, 1991, at 4B. The magistrate was angry because the indictments had been procured without either the grand jury or the agents' supervisors being informed of the role played by Checkmate. *State Cites Accountant for Helping IRS*, ST. LOUIS POST DISPATCH, Mar. 11, 1990, at 7D; see also *infra* notes 57, 60.

¹³ Geyelan and Pollack, *supra* note 12. Checkmate did not fight the action to remove his license. At 74 years of age and prepared to retire, he could not justify expenditures to save an unnecessary credential. Tim Bryant, *CPA Who Informed IRS Faces Penalty*, ST. LOUIS POST DISPATCH, June 5, 1990, at 3A.

¹⁴ See Berton, *supra* note 10.

enforcement and place a premium on privacy, which the law shields in varying degrees.

Admittedly having joined the *Journal* in exploiting reader interest in tales of criminal intrigue, betrayal, and law enforcement, this Note will attempt to provide a better understanding of the Service's current and likely future use of accountant-informants. This analysis will not purport to be "the final word," for the investigatory methods of the Service are shrouded in secrecy and there is little data available on the Service's use of accountant-informants. It may serve, however, to dispel the *Journal's* suggestion that the Service has launched a major attack on fiduciary relationships.

This Note will proceed by reviewing the law of accountant-client privilege and its treatment in criminal tax prosecutions. It will then discuss the Service's use of informants in criminal tax investigations and the importance of the *Rook* case, apparently the first case to confront the existence of accountant-informants.¹⁵ "Evading" the issues of whether and how accountant-client communications should be privileged,¹⁶ this Note will then discuss the use and likely future of the accountant-informant. An examination of supposed "direct" legal limitations on the use of accountant-informants will reveal that such limitations are, for the most part, illusory. An examination of hypothesized "indirect" limitations, however, will suggest that there are significant barriers to expanding the use of accountant-informants. Thus, this Note will conclude that, because there is little reason to believe Congress will intervene to prevent their use, the Service will continue to use accountant-informants in modest number. While not startling, this conclusion serves as a foil for the sensationalism of the *Journal* and suggests a simple, if counterintuitive, point: the Service often benefits from "bad press."

II. ACCOUNTANT-CLIENT PRIVILEGE

The *Rook* case came under media scrutiny not only because it involved the subterfuge of a fiduciary, but also because the magistrate hearing the case refused to recognize a statutory accountant-client privilege defense. The nature

¹⁵ The Service seems to have utilized accountants in other contexts. See, e.g., *United States v. Will*, 671 F.2d 963, 967 (6th Cir. 1982) (CPA permitted IRS agent to microfilm client files); see also *In re Impounded Case (Law Firm)*, 840 F.2d 196, 198 (3d Cir. 1988) (special agent based probable cause on information received from former law firm accountant). These cases, however, have not addressed the accountant-informant issue directly.

¹⁶ On this topic see, for example, Scott L. Kline, Note, *United States v. Arthur Young & Co.: Judicial Death Knell for Auditors' Privilege and Suggested Congressional Resurrection*, 71 CORNELL L. REV. 694 (1986) (arguing for legislatively-created auditor privilege for tax accrual workpapers to benefit securities registration system).

of the accountant-client privilege, and its treatment in the federal courts, is discussed below.

A. Testimonial and Lesser Privileges Under Statute

The only privileged relationships recognized at common law were the attorney-client and husband-wife relationships.¹⁷ Twenty-three states and the territory of Puerto Rico, however, have enacted statutes creating various forms of an accountant-client privilege.¹⁸ Some commentators suggest that these statutes were enacted merely to lend dignity to the accounting profession.¹⁹ Others suggest that the privilege is justified by a right to privacy, or because the privilege will promote more effective professional services.²⁰

Nine of the twenty-four accountant-client privilege statutes create exceptions to the privilege for disclosure in judicial proceedings.²¹ To this extent, these nine statutes do little more than codify a professional ethics rule,²²

¹⁷ See 8 JOHN H. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW §§ 2290, 2332 (McNaughton rev. ed. 1961).

¹⁸ Denzil Causey & Frances McNair, *An Analysis of State Accountant-Client Privilege Statutes and Public Policy Implications for the Accountant-Client Relationship*, 27 AM. BUS. L.J. 535, 538 (1990).

¹⁹ *Id.* at 546-48.

²⁰ *Id.* at 547 (citing Thomas G. Krattenmacker, *Testimonial Privileges in Federal Courts—Alternative to the Proposed Federal Rules of Evidence*, 62 GEO. L.J. 61, 85-86 (1973)).

²¹ See Causey & McNair, *supra* note 18, at 538.

²² *Id.* The American Institute of Certified Public Accountants has provided that:

A member in public practice shall not disclose any confidential client information without the specific consent of the client. This rule shall not be construed . . . (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, (3) to prohibit review of a member's professional practice under AICPA or state CPA society authorization, or (4) to preclude a member from initiating a complaint with or responding to any inquiry made by a recognized investigative or disciplinary body. Members of a recognized investigative or disciplinary body and professional practice reviewers shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with a recognized investigative or disciplinary body or affect, in any way, compliance with a validly issued and enforceable subpoena or summons.

2 AICPA PROFESSIONAL STANDARDS (CCH), 2 CODE OF PROFESSIONAL CONDUCT § 301 at 4671 (Feb. 1984) (CCH ed. 1988).

It should be noted that this rule provides for disclosure of information for peer review purposes. Some states have similar provisions in their accountant confidentiality statutes.

the practical effect of which is to create a cause of action for the violation of a client's confidences.²³ The remaining fifteen statutes, however, create a testimonial privilege.²⁴ The Missouri statute at issue in the *Rook* case, for example, provides:

A certified public accountant or a public accountant shall not be examined by judicial process or proceedings without the consent of his client as to any communication made by the client to him in person or through the media of books of account and financial record, or his advice, reports or working papers given or made thereon in the course of professional employment, nor shall a secretary, stenographer, clerk or assistant of a certified public accountant, or a public accountant, be examined, without the consent of the client concerned, concerning any fact the knowledge of which he has acquired in his capacity. This privilege shall exist in all cases except when material to the defense of an action against an accountant.²⁵

Presumably state courts accord these privilege statutes the same degree of deference granted other enactments of the state legislature.²⁶ Furthermore, to

See, e.g., Joseph V. Pease, Jr., *Quality Review and Confidentiality Laws*, TAX ADVISER 189 (Mar. 1992) (describing quality review provisions of accountancy act passed in Alaska in Spring 1991). Without such provisions, accountants must typically seek the client's written permission to disclose confidential information as part of a peer review system. Failure to do so, for example through a waiver provision in an engagement letter, will leave the accountant exposed to liability. *Id.* The signing of such a waiver or the presence of a safe harbor provision for peer review disclosure in the state confidentiality statute would negate expectations of privacy. *See supra* notes 86-98 and accompanying text.

²³ Such causes of action may exist independently under judge-made law. *See, e.g.,* *Wagenheim v. Alexander Grant & Co.*, 482 N.E.2d 955 (Ohio Ct. App. 1983).

²⁴ *Causey & McNair, supra* note 18, at 535-45. The jurisdictions creating a testimonial privilege are: Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Kansas, Maryland, Michigan, Missouri, Nevada, New Mexico, Pennsylvania, Puerto Rico and Tennessee. *Id.*

²⁵ MO. ANN. STAT. § 326.151 (Vernon 1989).

²⁶ *But see In re* October 1985 Grand Jury No. 746, 530 N.E.2d 453 (Ill. 1988), in which the Supreme Court of Illinois sustained a Cook County grand jury's subpoena of ostensibly confidential records in the possession of a tax accountant. *Id.* at 454, 460. The grand jury was investigating the alleged underpayment of Illinois income taxes, and the Illinois privilege statute provided: "A public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as a public accountant." ILL. REV. STAT. ch. 111, para. 5533 (1985). The Supreme Court of Illinois held that the statute was intended only to privilege information or evidence received by an accountant in his "confidential capacity," which capacity, stated the court, would not include accounting services with respect to taxation. 530 N.E.2d at 457-58. The legislative history, however, suggested that such statutory intent was that of the judiciary and the executive branch, not that of the legislature. The Illinois General Assembly, in response to an appellate court's determination that the accountant was required to comply with the subpoena, had approved an amendment to the statute that

the extent that they constitute part of the governing law in a diversity case, these statutes carry force in federal courts.²⁷ When state law claims are appended to federal questions, however, federal courts may accord these statutes less deference.²⁸ When a possible violation of the Internal Revenue Code is at issue, the statutes receive no deference at all: Despite state recognition of a special relationship between accountants and their clients, the federal courts have steadfastly refused to recognize an accountant-client privilege under federal law.²⁹ Against this background, the magistrate in the *Rook* case refused to dismiss the indictments against the defendant.³⁰

This Note now turns to a discussion of the refusal of the federal courts to recognize an accountant-client privilege in criminal tax prosecutions. It will be argued that this refusal leaves little room for counsel to protect clients from the wiles of their accountants, although in some unusual circumstances counsel may successfully employ a Fourth Amendment defense.

B. Treatment in Federal Criminal Tax Prosecutions

Federal courts now trace their refusal to recognize the accountant-client privilege in criminal tax prosecutions to two Supreme Court decisions, *Couch v. United States*³¹ and *United States v. Arthur Young & Co.*³² In *Couch*, an accountant possessed a client's business and tax records to assist the

provided: "This privilege . . . was intended to *include* but not be limited to any documents, information, or evidence obtained or used in connection with any tax services performed by the public accountant." 530 N.E.2d at 458 (emphasis added). The amendment was vetoed by the Governor. *Id.*

²⁷ See, e.g., *Commercial Union Ins. Co. of Am. v. Talisman, Inc.*, 69 F.R.D. 490 (D.C. 1975). The Federal Rules of Evidence provide that rules of privilege are to be determined according to state law when state law supplies the rule of decision. FED. R. EVID. 501.

²⁸ See, e.g., *Wm. T. Thompson Co. v. General Nutrition Corp.*, 671 F.2d 100 (3d Cir. 1982). The *Thompson* court held that when there are federal law claims in a case also presenting state law claims, the federal rule favoring admissibility, rather than any state law privilege, is the controlling rule. *Id.* at 104.

²⁹ See, e.g., *Olender v. United States*, 210 F.2d 795 (9th Cir. 1954); *Falsone v. United States*, 205 F.2d 734 (5th Cir. 1953); *Garipey v. United States*, 189 F.2d 459 (6th Cir. 1951); *Himmelfarb v. United States*, 175 F.2d 924 (4th Cir. 1949) (cases cited in *Couch v. United States*, 469 U.S. 322, 335 (1972)). See generally Phillip E. Hassman, *What Constitutes Privileged Communications with Preparer of Federal Tax Returns So As to Render Communication Inadmissible in Federal Tax Prosecution*, 36 A.L.R. FED. 686 (1978).

³⁰ See Bryant, *supra* note 11.

³¹ 409 U.S. 322 (1972).

³² 465 U.S. 805 (1984). See *United States v. Rockwell Int'l*, 897 F.2d 1255, 1265 (3d Cir. 1990) (citing *Arthur Young* for the nonexistence of a federal accountant-client privilege).

preparation of income tax returns.³³ The Service summoned the taxpayer's documents from the accountant.³⁴ The taxpayer challenged the summons, contending that the "extortion of . . . testimony or . . . private papers to be used as evidence"³⁵ violated the Fourth and Fifth Amendments to the Constitution.

The Court held that the Fifth Amendment privilege was unavailable, reasoning that the taxpayer had not been compelled to incriminate herself because the summons had been directed not at her, but at her accountant.³⁶ The Court then rejected the taxpayer's Fourth Amendment argument, that the confidential nature of the accountant-client relationship created an expectation of privacy rendering forced production of her records an unreasonable government search or seizure.³⁷ The Fourth Amendment was unavailable, the Court concluded, because there could be little expectation of privacy "where records are handed to an accountant, knowing that mandatory disclosure of much of the information therein is required in an income tax return" and that accountants might require the right to disclose the records to protect themselves under section 7206.³⁸

³³ *Couch*, 409 U.S. at 324.

³⁴ *Id.* at 325. The summons power derives from I.R.C. § 7602, which provides in pertinent part:

(a) **Authority to summon, etc.**—For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax, or collecting any such liability, the Secretary is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

I.R.C. § 7602 (West Supp. 1992). The Court has upheld a special agent's use of such a summons to further a tax investigation with "civil and possible criminal consequences." *See Donaldson v. United States*, 400 U.S. 517 (1971).

³⁵ *Couch*, 409 U.S. at 330.

³⁶ *Id.* at 322.

³⁷ *Id.* at 335.

³⁸ *Id.* But see G. Stevenson Smith, *Do Executives Believe They Have a Right to Privileged Communications with Their CPAs?*, 19 MID-ATLANTIC J. OF BUS. 15, 19 (1981).

The *Couch* decision reflects practical considerations. The tax system imposes upon citizens a duty of disclosure and relies heavily upon honest self-reporting. The undue extension of constitutional protections into the system would be problematic.³⁹ In dicta, however, the Court suggested another rationale for its decision: "Although not in itself controlling, we note that no confidential accountant-client privilege exists under federal law, and no state-created privilege has been recognized in federal cases."⁴⁰

The Court dealt with a section 7206 summons once again in *United States v. Arthur Young & Co.*⁴¹ Rather than assisting in the preparation of tax returns, however, the accountant in *Arthur Young* had been reviewing a corporation's financial statements to ensure compliance with federal securities laws.⁴² While reviewing the financial statements, the auditor prepared tax accrual workpapers relating to the evaluation of a reserve that had been set aside against contingent tax liabilities.⁴³ After a routine audit revealed questionable payments to a

(empirical evidence suggests executives generally expect that communications with their accountants will be kept in confidence and that lack of privilege hampers full and frank disclosure).

³⁹ *Couch*, 409 U.S. at 335.

⁴⁰ *Id.* In dissent, Justices Douglas and Marshall showed less concern for the federal tax system. According to Justice Douglas, the taxpayer's accountant is an agent for a specific purpose—the preparation of tax returns. As such, the accountant owes the petitioner-taxpayer fiduciary duties, including the duty not to use the taxpayer's records for unauthorized purposes. Under these circumstances, wrote Justice Douglas, it could hardly be said that the taxpayer does not have an expectation (presumably reasonable) of privacy. *Id.* at 340 (Douglas, J., dissenting).

Justice Marshall took an intermediate position. Marshall would have made the existence of a state accountant-client privilege a relevant consideration in determining whether there existed an expectation of privacy. *Id.* at 350 (Marshall, J., dissenting). He would also have made the complexity of the tax law a relevant consideration. "[P]rivileged or not," wrote Justice Marshall, "disclosure to an accountant is rather close to disclosure to an attorney. . . . If petitioner had sought to take advantage of some complicated provision of the tax laws, and needed the help of an accountant to do so, I would be quite reluctant to hold that the transfer of her records was a surrender of the privacy of the papers." *Id.* at 351. Justice Marshall's observation is particularly relevant to the *Rook* case because Checkmate had served as an advocate for Rook in a civil audit. Bryant, *supra* note 1. Thus, one would think Rook's expectation of privacy approached that which clients have in communications with their attorneys.

⁴¹ 465 U.S. 805 (1984).

⁴² *Id.* at 808-09.

⁴³ Tax accrual workpapers, the Court explained, pinpoint the "soft spots" in corporate tax returns by highlighting those areas in which the corporate taxpayer has taken a position that may later be challenged by the Internal Revenue Service. They may document interviews with corporate personnel, judgments on questions of potential tax liability, and suggestions for alternative treatments of certain transactions for tax purposes. *Id.* at 812-13.

“special disbursement account,” the Service instituted a criminal investigation and summoned the accountant’s workpapers.⁴⁴

When the accountancy and its client refused to comply with the summons, the Service brought, and succeeded in, an enforcement action. On appeal, the court of appeals determined that the workpapers were relevant to the Service’s investigation, but held that the public interest in promoting full disclosure to accountants, and thereby maintaining the integrity of securities markets, required the protection of the workpapers under a work-product immunity doctrine.⁴⁵ The Supreme Court disagreed, interpreting section 7206 strictly to support a congressional policy favoring disclosure of all relevant information.⁴⁶ The Court then used the dicta in *Couch* (to the effect that the federal courts do not recognize an accountant-client privilege) to support its holding that the appellate court’s work-product immunity doctrine had been erroneously forged.⁴⁷

Lower courts have read *Couch* and *Arthur Young* for the proposition that federal courts will not recognize an accountant-client privilege in tax enforcement matters. While it seems clear that there is no such privilege under these circumstances, neither of those cases actually presented a question of accountant-client privilege. *Couch* was a Fourth Amendment⁴⁸ and Fifth Amendment case, while *Arthur Young* was a matter of construing section 7206. The tendency of lower courts to gloss over the circumstances of cases before them and merely pronounce the nonexistence of an accountant-client privilege, then, reflects snowballing dicta rather than precise legal reasoning. Not all cases involving accountants fit the patterns of *Couch* and *Young*. When dealing with accountant-informants, practitioners, as discussed below, would do well to phrase their pleadings in terms of circumstances giving rise to reasonable expectation of privacy. Those who ignore the Fourth Amendment and argue for an accountant-client privilege climb the scaffold of their own volition.

⁴⁴ *Id.* at 808–09.

⁴⁵ *Id.* at 810; see *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), *rev’d in part*, 465 U.S. 805 (1984).

⁴⁶ *Arthur Young*, 465 U.S. at 817.

⁴⁷ *Id.*

⁴⁸ Both the Fourth Amendment and state accountant-client privilege seek to further social goals, such as privacy, in derogation of the search for truth. Their dimensions, however, are not coextensive. Courts have not been meticulous in distinguishing the two bodies of law and their application to cases under consideration.

III. USE OF THE ACCOUNTANT-INFORMANT BY THE SERVICE

An analysis of accountant-informants requires an explanation of the purposes, processes, and authority governing their use. Within the limits of available public information on these matters, such discussion proceeds below.

A. *Criminal Investigations and Informants Generally*

In general, criminal sanctions for willful violation of the Internal Revenue Code are imposed under Internal Revenue Code sections 7201-7207 and relevant sections of the United States Criminal Code.⁴⁹ Criminal investigations are carried out by the Criminal Investigation Division of the Internal Revenue Service and, upon referral, by the Department of Justice.⁵⁰ Most investigations are prompted by referrals from special agents and other divisions of the Service. Some, however, proceed upon the receipt of tips from the public and other government agencies.⁵¹

As part of a criminal investigation, the Service may rely on information supplied by informants. The use of informants to secure such information is authorized by the *Internal Revenue Manual*.⁵² Informants may supply information on their own initiative or be urged to do so by the Service,⁵³ and these efforts may sometimes be financially rewarded.⁵⁴ The information

⁴⁹ The following sections of Title 18 of the U.S. Code (the U.S. Criminal Code) are frequently used in tax prosecutions: § 2 (aiding and abetting); § 201 (bribery); § 371 (conspiracy); § 1001 (false statements); and § 1621 (perjury). See MICHAEL D. ROSE & JOHN C. CHOMMIE, *FEDERAL INCOME TAXATION*, § 13.31, at 822 (3d ed. 1988 & Supp. 1989).

Most prosecutions seem to be brought under Internal Revenue Code sections 7201, 7203, and 7206. Section 7201 provides criminal sanctions for persons willfully attempting to evade or defeat any tax or tax payment. Section 7203 provides criminal sanctions for willful failure to pay a tax when due, to file a timely return (other than a declaration of estimated income), to keep records, or to supply required information. Section 7206 provides criminal sanctions for several defined felonies, including preparing or assisting in the preparation of fraudulent or false returns or other documents. I.R.C. §§ 7201, 7203, 7206 (1991).

⁵⁰ See SALTZMAN, *supra* note 7, at 12-8 n.23.

⁵¹ *Id.* at 12-9, 12-10.

⁵² 6 I.R.M. (CCH) § 9373.2, at 28,175 (Mar. 24, 1989). The Supreme Court has upheld the use of informants to obtain incriminating evidence against defendants. See *Hoffa v. United States*, 385 U.S. 293 (1966).

⁵³ 6 I.R.M., *supra* note 52, § 9373.2(1), at 28,175.

⁵⁴ *Id.*

gathered from informants will typically be used to establish the elements of willfulness and misrepresentation of income.⁵⁵

Informants fall into one or more of several categories. "Anonymous informants" are those who either refuse to identify themselves or who use fictitious names and whose true identities are unknown to the Service.⁵⁶ "Confidential informants" are those who request that their names be held in strict confidence,⁵⁷ while "non-confidential" informants, as one might expect, make no such requests.⁵⁸ "Controlled informants," such as Checkmate, are those informants who are paid for the information they voluntarily provide or who, unpaid, provide information at the urging of a special agent.⁵⁹ The Service's internal guidelines provide that special agents are to obtain authorization for controlled informants before directing them to gather information on noncompliance.⁶⁰

One agent has posited that people are motivated to serve as informants by their patriotism.⁶¹ The facts of the *Rook* case and the existence of a reward program, however, suggest that noble motivations are the exception rather than the rule. The rule is that informants are motivated by hatred, extrinsic rewards, and the prospect of their own punishment.

Hatred or revenge may be assumed to be a prime motivator because many informants are former spouses and employees. A variation on this theme appears in the colorful *United States v. Miceli*.⁶² In that case the defendant's estranged wife not only served as an informant, but also clumsily broke into the defendant's office to steal documents.⁶³ Revenge was undoubtedly sweet, but it was by no means the lonely Mrs. Miceli's only reward: in exchange for her

⁵⁵ Without the help of an informant, the Service uses several different methods to prove indirectly the existence of income the taxpayer has failed to report. These methods include the net worth method, the case expenditure method, the bank deposits method, and the percentage mark-up method. The net worth method, used in *Costello v. United States*, 350 U.S. 359 (1956), is the most widely used. Under this method an estimate of income is calculated from the difference between the person's beginning and end-of-the-year total assets, as adjusted for nondeductible personal expenditures. See ROSE & CHOMMIE, *supra* note 49, at 826, 827.

⁵⁶ 6 I.R.M., *supra* note 52.

⁵⁷ *Id.* § 9373.2(1)(c). These confidentiality provisions may allow agents to conceal from supervisors the fact that the informant is an accountant, apparently the situation in the *Rook* case. See *supra* note 12; see also *infra* note 60.

⁵⁸ 6 I.R.M., *supra* note 52, § 9373.2(1)(b).

⁵⁹ *Id.* § 9373.2(d).

⁶⁰ *Id.* The Service's failure to follow its own internal guidelines, however, may be insufficient cause to dismiss charges against a taxpayer. See *United States v. Caceres*, 440 U.S. 741 (1979).

⁶¹ See Berton, *supra* note 10.

⁶² 774 F. Supp. 760 (W.D.N.Y. 1991).

⁶³ *Id.* at 764.

information, the controlling special agent wined, dined, and had sexual relations with her.⁶⁴ Not all that glisters, however, is gold.⁶⁵ Mrs. Miceli testified that after having sex with her the agent told her that he would be keeping "in touch."⁶⁶ The agent's next and final "touch," however, consisted of no more than a touch-tone telephone call described at trial as a "very cold professional conversation."⁶⁷

The prospect of extrinsic rewards exists because the Internal Revenue Code authorizes the Secretary of the Treasury to pay such sums as deemed necessary "for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same, in cases where such expenses are not otherwise provided for by law."⁶⁸ Service employees are forbidden to urge individuals to inform for the sake of monetary rewards, however, and they are prohibited from assuring any person that a reward of any amount will be forthcoming.⁶⁹ Rewards are not paid except with respect to taxes, fines, and penalties *actually collected*, and only then if the information leading to the collection was voluntarily provided on the informant's initiative.⁷⁰ The amount of the reward, if any, is to be determined with regard to the relative value of the information furnished.⁷¹ Informants are kept ignorant of this value.⁷²

⁶⁴ *Id.*

⁶⁵ See, e.g., Thomas Gray, *Ode on the Death of a Favorite Cat, Drowned in a Tub of Gold Fishes*, in FRANCIS TURNER PALGRAVE, *THE GOLDEN TREASURY* 112, 113 (5th ed. 1964).

⁶⁶ *Miceli*, 774 F. Supp. at 764.

⁶⁷ *Id.*

⁶⁸ I.R.C. § 7623 (West Supp. 1992).

⁶⁹ 6 I.R.M. (CCH) § 9371.4(6), at 28,173 (Sept. 9, 1991).

⁷⁰ 6 I.R.M. (CCH) § 9371.5, at 28,173 (Apr. 3, 1986).

⁷¹ *Id.*

⁷² "[N]or should I.R.S. personnel indicate to an informant in any manner the amount of the probable tax recovery or whether such recovery is based upon the information submitted by the informant." 6 I.R.M., *supra* note 69.

In the year ending September 30, 1992, the Service received 10,966 claims for bounty. Of these claims, 671 rewards, totaling \$1.7 million, were paid. These tips enabled the service to recover an extra \$83.7 million in revenue. In 1991, 732 rewards were paid on 9,907 claims. The \$1.5 million paid reflected the recovery of \$58.4 million in revenue. Over the 1991-92 period, then, the Service paid some 6.7% of the claims made with some 2.3% of the revenues collected. The rewards, of course, must be included in the snitch's gross income. I.R.C. § 61 (1991). See Tom Herman, *Snitching for Dollars*, WALL ST. J., Dec. 9, 1992, at A1.

As noted above, many informants are motivated by the possibility of punishment.⁷³ Sometimes the Service has the informant "over a barrel" for nonpayment of taxes.⁷⁴ The Service is then in a position to file and execute a lien against the taxpayer-informant's property if the taxpayer refuses to "cooperate."⁷⁵ There have been efforts to limit the discretion of the Service with respect to the overdue taxes of informants.⁷⁶ These efforts, however, have not yet amounted to a significant challenge to the use of accountant-informants.

While the motives of informants make for fascinating discussion, so too do the circumstances that made the *Rook* case a media event. These circumstances are briefly discussed below.

B. *The Rook Case: The Special Case of the Accountant-Informant*

The *Rook* case was the first to publicize the Service's use of accountants as informants,⁷⁷ and at first glance there seems little reason to believe the Service was pleased with the publicity. Given the availability of alternative enforcement methods,⁷⁸ many people think it undesirable to fight tax fraud by corrupting parties with special duties of loyalty. Many also consider it unseemly for the federal government to coerce people on the verge of bankruptcy to prostitute themselves and thereby jeopardize their futures and reputations as professionals.

Although the Service might seem to have suffered from negative publicity, however, some might suggest that the use of accountant-informants will grow. Moles are an efficient means of gathering intelligence, and as one agent has put it, "with its limited budget, [the Service] needs all the help it can get to catch the country's tax evaders."⁷⁹ Others might argue that the courts have created a favorable climate for the use of accountant-informants by mechanically

⁷³ "Fear is a great motivator and is maintained by a dread of punishment which never fails." NICCOLO MACHIAVELLI, *THE PRINCE* 74 (Luigi Ricci trans., Oxford Univ. Press 1935).

⁷⁴ See *supra* note 3.

⁷⁵ See I.R.C. §§ 6321-23 (West Supp. 1992).

⁷⁶ See *Tax Report*, WALL ST. J., Mar. 11, 1992, at A1 (Senate Finance Committee tax bill would make it a crime for federal agents to offer forgiveness of taxes to induce lawyers, CPAs, or practitioners known as enrolled agents to inform on their clients).

⁷⁷ See Bryant, *supra* note 1. An earlier case featuring a financial advisor seems to have escaped media attention. See *infra* note 141 and accompanying text.

⁷⁸ In arguing for the admissibility of evidence received from Checkmate, the Service claimed that any documents received from Checkmate relating to Rook's business could easily have been obtained through normal tax audit proceedings. Berton, *supra* note 10.

⁷⁹ *Id.* An internal survey prompted by the *Rook* case indicated that of 880 controlled informants used by the Service, some 40 were accountants. *Id.*

asserting that there is no accountant-client privilege.⁸⁰ As argued above, however, neither *Couch* nor *Arthur Young* necessarily support this proposition. Although the Internal Revenue Code summons provision⁸¹ may evidence a policy against allowing accountants to impede tax compliance,⁸² Congress has never approved of the practice of inducing fiduciaries to breach their duties. The refusal of the federal courts to recognize an accountant-client privilege, however, raises two questions about the use of accountant-informants: (1) whether the use of accountant-informants is limited directly by the Constitution or other laws; and (2) if there are no or few legal limitations on the use of accountant-informants, whether such use is otherwise constrained.

IV. THE (LIMITED) DIRECT LIMITATIONS ON THE USE OF ACCOUNTANT-INFORMANTS

Members of the defense bar have argued that clients are protected against accountant-informants by the Fourth Amendment and the Due Process Clause of the Fifth Amendment.⁸³ They have also argued that the federal courts may

⁸⁰ See, e.g., *United States v. Rockwell Int'l*, 897 F.2d 1255, 1265 (3d Cir. 1990).

⁸¹ See *supra* note 34.

⁸² See *United States v. Arthur Young & Co.*, 465 U.S. 805, 817 (1984).

⁸³ See, e.g., *United States v. Miceli*, 774 F. Supp. 760 (W.D.N.Y. 1990); see also Bryant, *supra* note 11.

Two points are in order with respect to the Fifth Amendment Self-Incrimination Clause. First, barring extraordinary circumstances, statements made by the taxpayer to the accountant-informant will not be regarded as privileged, self-incriminating statements. Tax investigations, which frequently lead to criminal prosecutions, are not immune from the requirements of *Miranda v. Arizona*, 384 U.S. 436 (1966), regarding warnings to be given to a person in custody. See *Mathis v. United States*, 391 U.S. 1 (1968) (documents obtained during interviews of taxpayer-prisoner by revenue agent held inadmissible when taxpayer had not been read *Miranda* warnings). A special agent's interview, however, does not by itself amount to a custodial interrogation and does not require full *Miranda* warnings. *Beckwith v. United States*, 425 U.S. 341 (1976). By extension, incriminating responses to noncustodial questioning by an account-informant will not implicate the Self-Incrimination Clause.

Second, there is no self-incrimination when taxpayer documents are surrendered to the Service by the taxpayer or a third party. In *Garner v. United States*, 424 U.S. 648 (1976), the petitioner-taxpayer's income tax returns, which revealed his gambling activities, were introduced into evidence as proof of the federal gambling conspiracy charge against him. *Id.* at 649-50. Reasoning that petitioner made the incriminating disclosures on his returns instead of claiming the privilege, the Court held that the petitioner's disclosures were not compelled and that petitioner's Fifth Amendment rights were not implicated. *Id.* at 665. Furthermore, tax workpapers of an accountant or attorney prepared before any compulsion in the form of a summons or other process are not privileged under the Fifth Amendment. The Fifth Amendment protects against compelled self-incrimination, not the disclosure of

use their supervisory powers to shield the client's communications to the accountant.⁸⁴ For *most* cases involving accountant-informants, *most* of these defenses will be without merit. For *all* cases involving accountant-informants, some of these defenses will *always* be without merit.

A. *A Shot in the Dark: Protection from Unreasonable Searches*

The Fourth Amendment prohibits unreasonable searches.⁸⁵ A "search" within the meaning of the Fourth Amendment exists when there is an intrusion upon an actual expectation of privacy that society regards as reasonable.⁸⁶ Such a search, however, is not unconstitutional unless the search is itself unreasonable.⁸⁷ Furthermore, even if a search is unreasonable, as a general rule the Fourth Amendment offers no protection against searches carried out by private parties.⁸⁸ The exception to this rule occurs when it can be shown that the ostensibly private party conducting the search is actually an instrument or agent of the government.⁸⁹ Whether a party is an instrument or agent of the government is determined by the totality of the circumstances.⁹⁰ Two factors critical to determining whether a party is an instrument or agent are: (1) whether the government had knowledge of, and acquiesced to, the search; and (2) whether the search was carried out for law enforcement purposes.⁹¹

It is improbable that an accountant without prior government ties who voluntarily passes client information to the Service on a single occasion would be deemed an agent of the government. Arguably, the only critical factor present in such a scenario would be that the intrusion took place for law enforcement purposes. The accountant who gathers information at the bidding of a special agent, however, would almost assuredly be labeled an instrument of the government. The intrusion would be undertaken for law enforcement purposes and the government would have knowledge of the accountant's

private information. *Andresen v. Maryland*, 427 U.S. 463 (1976); *Garner v. United States*, 424 U.S. 648 (1976).

⁸⁴ See, e.g., *Miceli*, 774 F. Supp. at 760.

⁸⁵ The Fourth Amendment provides:

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

U.S. CONST., amend. IV.

⁸⁶ See, e.g., *California v. Greenwood*, 486 U.S. 35, 39 (1988).

⁸⁷ See, e.g., *Carroll v. United States*, 267 U.S. 132, 147 (1925).

⁸⁸ *Burdeau v. McDowell*, 256 U.S. 465, 475 (1921).

⁸⁹ See *United States v. Jacobsen*, 466 U.S. 109, 113-14 (1984).

⁹⁰ See *Skinner v. Railway Labor Executives' Ass'n*, 489 U.S. 602, 614 (1989).

⁹¹ See, e.g., *United States v. Feffer*, 831 F.2d 734, 739 (7th Cir. 1987).

actions. Even in this situation, however, ordinarily Fourth Amendment prohibitions would be without effect. As the Court stated in *Couch*, there is no expectation of privacy in the conveyance of information to be used for the purpose of preparing tax returns.⁹² With no reasonable expectation of privacy, there is no "search" for Fourth Amendment purposes.⁹³ In the generic accountant-informant case, then, the protections of the Fourth Amendment will be unavailable.

It would be precipitous to conclude, however, that every use of an accountant is without a reasonable expectation of privacy. Accountant-client privilege statutes and common-law liability for nonconsensual disclosures of confidential matters indicate that accountants owe duties to their clients and suggest that in many circumstances expectations of privacy are reasonable.⁹⁴ The Court's refusal to find an expectation of privacy in the use of a tax accountant in *Couch* was based on the need to protect the tax system and on the genuine belief that the defendant in that case had no actual expectation of privacy. After all, the taxpayer in that case had assembled the information for public disclosure. A court could reach a contrary decision, however, in a case involving an accountant who discovers information while undertaking activities not intended to result in disclosure. Reliance on accountants who perform sensitive private accounting functions could conceivably create an expectation of privacy that society might regard as reasonable, especially if the employer is of a type not obligated to report its financial results to the public⁹⁵ and the accountant's role in tax preparation is merely incidental.⁹⁶ Thus, for example, if the proprietor of a small business employed an accountant to generate information for internal reporting purposes,⁹⁷ and the same accountant, an

⁹² *Couch v. United States*, 409 U.S. 322, 335 (1973).

⁹³ *See California v. Greenwood*, 486 U.S. 35, 39 (1988).

⁹⁴ *See supra* notes 38 & 40.

⁹⁵ For example, a non-SEC reporting company.

⁹⁶ The first of these qualifications, that the employer is not obligated to disclose its financial data to the public, avoids the situation in *Arthur Young*. The second is designed to avoid the situation in *Couch*. *See supra* notes 42, 33 and accompanying text. The possibility that "much of the information . . . is required in an income tax return," *Couch*, 409 U.S. at 335, cannot be determinative of privacy rights. Were such the case, police officers could snatch a sealed note from an unsuspected person, read it, and not violate the Fourth Amendment if perchance the note included only a taxpayer's name, address, and signature (information regularly disclosed on a tax return) along with a brief message, e.g., "you are my accountant and I love you."

⁹⁷ One such internal reporting function could be variance analysis. Variance analysis involves comparing actual costs against standards for what a given activity should cost. It can be used to pinpoint problems in the production process and to assign responsibility for cost overruns. This "internal reporting" is to be contrasted with "external reporting," e.g., the mandatory disclosure for tax or security law purposes that destroys legitimate expectations of privacy. *See* ROBERT ANTHONY & JAMES REECE, ACCOUNTING: TEXT AND

informant, volunteered to help the owner with the owner's income taxes, a court might be justified in finding that the taxpayer-owner's expectation of privacy was reasonable. Because most American corporations are privately held and need not report financial results to the public, and because many American businesses are carried out by sole proprietors who prepare their own taxes, it should not be assumed that the existence of an accountant who comes into contact with tax preparation materials automatically destroys an otherwise legitimate expectation of privacy. Thus the Fourth Amendment might create a valid defense although the accountant-client privilege does not.⁹⁸

Because this Fourth Amendment defense is something of a shot in the dark, defense attorneys have quite properly sought alternatives. As discussed below, however, the alternatives suggested thus far are unlikely to succeed.⁹⁹

B. Other Professed Limitations; Due Process and Supervisory Powers

Members of the defense bar have claimed that the use of accountant-informants violates the Fifth Amendment Due Process Clause and that the courts can contain the practice through their supervisory powers.¹⁰⁰ The Due Process Clause provides that "[n]o person shall . . . be deprived of life, liberty,

CASES 693-731 (8th ed. 1989) (illustrating variance analysis as aspect of managerial accounting).

⁹⁸ In what appears to be a suit under 42 U.S.C. § 1983, a cause of action for violation of Fourth Amendment rights is being urged in a late-breaking accountant-informant case. SafeCard Services, Inc. filed suit against its former tax accountant, Ernest A. Varvoutis III, the Internal Revenue Service, and named Internal Revenue Service agents on October 9, 1992 in federal court in Fort Lauderdale. The suit seeks \$58 million, including punitive damages, for injuries resulting from unreasonable searches and seizures. The suit alleges that Varvoutis, at the behest of Internal Revenue Service agents, gave the Service documents belonging to the taxpayer to be used to establish probable cause for a search warrant. The suit alleges that, in a gross display of bootstrapping, the search warrant that issued as a result of establishing probable cause with the purloined documents was used to seize the same documents, which in the meantime had been returned to the company. See Kurt Eichenwald, *SafeCard's Dispute with U.S. Grows*, N.Y. TIMES, Oct. 12, 1992, at D4; Amy Bach, *Big Suits*, THE AM. LAW., Dec. 1992 at 70-72.

⁹⁹ In passing, it should be noted that the Sixth Amendment right to counsel defense is not an alternative because the work of the accountant-informant is accomplished *before* the client is charged. The Court has limited the attachment of an accused's Sixth Amendment right to counsel to those critical stages "at or after the time that judicial proceedings have been initiated against him—'whether by way of formal charge, preliminary hearing, indictment, information, or arraignment.'" See *Brewer v. Williams*, 430 U.S. 387, 398 (1977) (citing *Kirby v. Illinois*, 406 U.S. 682, 689 (1972)). Thus, the Sixth Amendment right to counsel does not attach until the government has committed itself to prosecution. *Kirby*, 406 U.S. at 682. The fact that an investigation has focused on a taxpayer is insufficient to demonstrate that the government has committed itself to prosecute. See *Hoffa v. United States*, 385 U.S. 293 (1966).

¹⁰⁰ See, e.g., *United States v. Miceli*, 774 F. Supp. 760 (W.D.N.Y. 1990).

or property, without due process of law.”¹⁰¹ The Court has stated that the Due Process Clause “inescapably imposes . . . an exercise of judgment upon the whole course of the proceedings [resulting in a conviction] in order to ascertain whether they offend those canons of decency and fairness which express the notions of justice of English-speaking peoples even toward those charged with the most heinous offenses.”¹⁰² Consistent with this statement, the Court as used the Due Process Clause to suppress evidence gathered in means shocking to the conscience.¹⁰³ In *Rochin v. California*,¹⁰⁴ for example, police officers had a physician pump the stomach of a suspect who ingested drugs as the police burst into his bedroom.¹⁰⁵ The Court held that the police had obtained Rochin’s conviction by methods offensive to the Due Process Clause.¹⁰⁶

While the Court has not foreclosed use of the Due Process Clause to curb overzealous law enforcement, it has been reluctant to resort to it. In *United States v. Russell*,¹⁰⁷ for example, the defendant alleged that the government had acted outrageously when undercover narcotics officers provided him with a scarce ingredient for the manufacture of methamphetamine, a crime for which he was convicted.¹⁰⁸ The Court summarily rejected the defendant’s due process claim, but noted in dicta that “we may some day be presented with a situation in which the conduct of law enforcement agents is so outrageous that due process principles would absolutely bar the government from invoking judicial processes to obtain a conviction.”¹⁰⁹

One reason for the Court’s reluctance to use the Due Process Clause to rectify official wrongdoing is the threat such use poses to the separation of powers.¹¹⁰ Another reason is the existence of alternative remedies.¹¹¹ Thus in *Hampton v. United States*,¹¹² another narcotics entrapment case, a plurality of the Court suggested that if the police join in illegal activity with a defendant beyond the scope of their duty, the remedy lies not in freeing the culpable defendant through the Due Process Clause, but in prosecuting the police under applicable provisions of state or federal law.¹¹³

¹⁰¹ U.S. CONST., amend. V.

¹⁰² *Malinski v. New York*, 324 U.S. 401, 416–17 (1945).

¹⁰³ *See, e.g., Rochin v. California*, 342 U.S. 165, 172 (1952).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 166.

¹⁰⁶ *Id.* at 172. *Rochin* has been limited to situations involving coercion, violence, or brutality to the person. *See Irvine v. California*, 347 U.S. 128, 133 (1954).

¹⁰⁷ 411 U.S. 423 (1973).

¹⁰⁸ *Id.* at 424.

¹⁰⁹ *Id.* at 431–32.

¹¹⁰ On this issue see *infra* note 121 and accompanying text.

¹¹¹ *See, e.g., Rochin*, 342 U.S. at 170–72.

¹¹² 425 U.S. 484 (1990).

¹¹³ *Id.* at 490.

Some members of the defense bar have asked the courts to use their supervisory powers to suppress evidence taken from within fiduciary relationships.¹¹⁴ The Supreme Court's treatment of the supervisory powers, however, closely parallels its treatment of the Due Process Clause, and the federal courts will not easily be convinced to invoke them.

The Court's understanding of the scope, if not the purposes, of the "inherent" supervisory powers has evolved. In *McNabb v. United States*,¹¹⁵ the Court implicitly defined the purposes of the powers by stating that they could be used to exclude evidence: (1) to deter illegal conduct by government officials; and (2) to protect the integrity of the federal courts by preventing them from becoming accomplices to misconduct.¹¹⁶ As for the scope of the powers, members of the Court once understood the scope of the powers to be expansive.¹¹⁷ That understanding has since been refined, however, as their range of operation has been constricted from the prevention of *misconduct* to the prevention of *illegal conduct that constitutes an outright violation of existing constitutional rights*.¹¹⁸ Thus, for example, if government agents steal from an accountant evidence tending to incriminate the accountant's client, the supervisory powers probably would be of no avail:

The supervisory power does not authorize a federal court to suppress otherwise admissible evidence on the ground that it was seized unlawfully from a third party not before the court. Our Fourth Amendment decisions have established beyond any doubt that the interest in deterring illegal searches does

¹¹⁴ See *United States v. Miceli*, 774 F. Supp. 760 (W.D.N.Y. 1990). A Due Process Clause claim is being asserted in a companion suit to the SafeCard action. See *supra* note 98; see also Gregg Fields, *Accountant Faces Suits by SafeCard*, MIAMI HERALD, Oct. 13, 1992, at C1.

¹¹⁵ 318 U.S. 332 (1943).

¹¹⁶ *Id.* at 345, 347.

¹¹⁷ Thus, for example, in a famous dissent Justice Brandeis wrote:

Decency, security and liberty alike demand that government officials shall be subjected to the same rules of conduct that are commands to the citizen. In a government of laws, existence of the government will be imperiled if it fails to observe the law scrupulously. Our Government is the potent, the omnipresent teacher. For good or for ill, it teaches the whole people by its example. Crime is contagious. If the Government becomes a lawbreaker, it breeds contempt for the law; it invites every man to become a law unto himself; it invites anarchy. To declare that in the administration of the criminal law the end justifies the means—to declare that the Government may commit crimes in order to secure the conviction of a private criminal—would bring terrible retribution. Against that pernicious doctrine this Court should resolutely set its face.

Olmstead v. United States, 277 U.S. 438, 485 (1928) (Brandeis, J., dissenting).

¹¹⁸ See, e.g., *United States v. Payner*, 447 U.S. 727 (1980).

not justify the exclusion of tainted evidence at the instance of a party who was not the victim of the challenged practices.¹¹⁹

As with the Court's reluctance to use the Due Process Clause, the narrowing of the supervisory powers may be explained in part by the Court's fear of upsetting the constitutional balance. Thus in *United States v. Payner*¹²⁰ former Chief Justice Burger wrote that "[o]rderly government under our system of separate powers calls for internal self-restraint and discipline in each Branch; this Court has no general supervisory authority over operations of the Executive Branch, as it has with respect to the federal courts."¹²¹ Consequently, although judges may grow angry at the methods of the Service, it is unlikely that evidence gathered by offensive, but not clearly unconstitutional, techniques will be suppressed under the supervisory powers.

Given the difficulties of a Fourth Amendment defense and the apparent irrelevance of the Fifth Amendment and the supervisory powers, this Note turns to an examination of natural or "indirect" limitations on the use of accountant-informants.

V. INDIRECT LIMITATIONS ON THE USE OF ACCOUNTANT-INFORMANTS

Given the suggestion that accountant-informants are the wave of the future,¹²² an inquiry into natural or "indirect" limitations on the use of accountant-informants is appropriate. Indirect limitations include factors other than the legal defenses available to taxpayer-targets that tend to affect the willingness of the Service to use accountant-informants, the willingness of accountants to serve as informants, or both. Economic theory, which provides a useful framework for understanding indirect limitations, suggests that the prospect of an accountant reign of terror is remote; the quantity of accountant-informant services demanded by the Service will likely be *de minimis*, as will be the quantity supplied by accountants.

A. *Optimal Reliance*

As part of its goal of ensuring compliance, the Service is concerned about its public image. "The highest priority of Criminal Investigation is to create a maximum positive impact on the compliance attitudes and practices of

¹¹⁹ *Id.* at 735 (citing *Rakas v. Illinois*, 439 U.S. 128, 137 (1978)).

¹²⁰ 447 U.S. 727 (1980).

¹²¹ *Id.* at 737 (Burger, C.J., concurring). See generally Sara Sun Beale, *Reconsidering Supervisory Power in Criminal Cases: Constitutional and Statutory Limits on the Authority of the Federal Courts*, 84 COLUM. L. REV. 1433 (1984).

¹²² See Berton, *supra* note 10.

taxpayers through an effective General Enforcement Program (GEP). Within GEP, priority will be given to high impact coordinated compliance projects."¹²³ Faced with budget constraints, the Service strives to maximize deterrence (and hence compliance) by pursuing high-visibility targets likely to be convicted.¹²⁴ Consequently, the Service enjoys the limelight: "the Service will endeavor to obtain news coverage of its enforcement activities in order to help deter violations of the internal revenue laws and increase the confidence of conscientious taxpayers that the Service prosecutes violators."¹²⁵

Given the Service's objectives it is appropriate to ask whether the use of accountant-informants creates the type of public perception the Service desires. One might suppose that in the short-run the use of accountant-informants to nab noncomplying parties is an attractive strategy. Accountant-informant are an inexpensive and effective weapon.¹²⁶ In the long-run, however, a public put off by the Service's lack of "fair play" and "unlawfulness" could grow hostile towards the Service and seek congressional limitations on the use of accountants-informants.¹²⁷ This type of long-run and short-run analysis, however, is a simplistic and likely erroneous approach to understanding the merits and future of the accountant-informant strategy.

A better understanding of the accountant-informant strategy appreciates the ability of accountant-informants not only to scuttle their clients, but also to signal to the public the "public-relations cost" the Service is willing to bear to bring offenders to justice. To borrow from game theory,¹²⁸ the Service should

¹²³ 6 I.R.M. (CCH) § 9161.1, at 28,021-5 (Aug. 16, 1979).

¹²⁴ See SALTZMAN, *supra* note 7, at 12-2, 12-3.

¹²⁵ 6 I.R.M. (CCH) § 9161.6, at 28,022 (June 6, 1979).

¹²⁶ See Berton, *supra* note 10; see also *supra* note 79.

¹²⁷ See *supra* note 76. For examples of "traditional" public hostility towards the Service, see Ellen Schultz, "Misery II" Could Be a Stephen King Book About IRS Agents, WALL ST. J., April 14, 1992, at A1 (agents are shot at, ridiculed socially, attacked by dogs; taxpayers file bogus liens against them and report payments to them to suggest the agents are themselves underreporting income).

¹²⁸ Game theory is a branch of economics founded by John Von Neumann and Oskar Morgenstern. See JOHN VON NEUMANN & OSKAR MORGENSTERN, *THEORY OF GAMES AND ECONOMIC BEHAVIOR* (1944). Game theory can be used to understand competitive situations and predict their outcomes. One such situation arises with respect to income taxes. Although the tax system also relies on voluntary compliance, at bottom its integrity depends upon compulsion. Compulsion is needed to ensure compliance because the objective of the taxpayer is incompatible with the objective of the Service. The taxpayer seeks to minimize taxes paid, while the Service seeks to maximize taxes paid. Thus, the taxpayer and the Service are involved in a competitive situation.

Each "player" in this situation has a choice of strategies to cope with a world of uncertainty. The Service, faced with uncertainty about the compliance behavior of the taxpayer, may choose to investigate the taxpayer or not investigate the taxpayer. The taxpayer, faced with uncertainty about the actions of the Service, may choose to comply or

be viewed as a participant in an iterated game with taxpayers.¹²⁹ As part of this game, the Service may rationally make a strategic move.¹³⁰ One such move, to be distinguished from a mere threat, is the *credible commitment* to deterrence.¹³¹ By incurring a sizeable public relations cost through playing the accountant-informant strategy, the Service indicates that it is deadly serious about prosecution—a crucial requirement for credible deterrence. The long-run payoffs to the “playing nasty” strategy transcend the payoffs to sinking the individual tax criminal and represent the returns to an investment in reputation. The beauty of the strategy is that, once the reputation is established, the Service need not rely extensively on accountant-informants. In other words, some limited resort to accountant-informants is sufficient to maintain a reputation and to further the Service’s mission of ensuring compliance. Ironically, then, rather than harming the Service, to the extent the *Wall Street Journal*’s coverage of the *Rook* case suggested a season in the sun for accountant-informants, the *Journal* served as an instrument of the Service’s strategy. That is to say, it would not be inappropriate to call the *Journal* a “capitalist tool.”

not comply. Because their objectives are incapable of alignment, the taxpayer-Service game is called a “noncooperative” game. That is, there are no negotiable and enforceable joint strategies the two players can pursue to obtain a common objective. See generally PAUL A. VATTER ET AL., *QUANTITATIVE METHODS IN MANAGEMENT* 483-550 (1978); ROBERT PINDYCK & DANIEL RUBINFELD, *MICROECONOMICS* 459 (1989).

¹²⁹ Equilibria in iterated, or repeated, games can differ qualitatively from those of identical games played only once. Furthermore, equilibria in iterated games may depend on whether the game will be iterated *ad infinitum* or only a finite number of times.

Results in iterated games can differ from those in one-shot games because the past provides a clue: iterated games provide information about the strategy the other player is likely to choose. In an iterated game a player may develop a reputation for using a certain strategy. This reputation will be considered by a rational opponent.

Results in finite iterated games may differ from those in infinitely iterated games because players who know of some “final round” also know that their opponents have an incentive in that round to deviate from equilibrium strategies that might otherwise evolve. If a player has an incentive to deviate in a known final round, a rational opponent will adjust his or her behavior accordingly. A rational player, however, would expect an opponent to adjust his or her behavior in this manner and, anticipating the opponent’s behavior in the final round, will adjust his or her own behavior in the penultimate round, and so on and so forth. Thus, finite iterated games can have solutions different from those in otherwise identical infinitely iterated games because a player can “see what is coming.” See PINDYCK & RUBINFELD, *supra* note 128, at 466-68.

¹³⁰ “A strategic move is one that influences the other person’s choice, in a manner favorable to one’s self, by affecting the other person’s expectations on how one’s self will behave.” THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* 160 (1960).

¹³¹ See PINDYCK & RUBINFELD, *supra* note 128, at 471-82. Credible commitments require a “double-take.” At first glance, the actor appears to be acting against self-interest. When the viewer has some perspective, however, it is apparent that the actor is purposefully “hurting” himself to achieve some greater end—that which will be achieved by affecting the expectations of opponents.

The game-theoretic understanding of the long-range benefits of the accountant-information strategy is strengthened to the extent that the "naive" analysis hypothesized earlier can be discredited. An important element of that analysis was the assumption that the public would successfully pressure Congress to limit the use of accountant-informants. Certain derivative effects of the accountant-informant strategy, as well as the nature of collective action, however, suggest such pressure is unlikely.

One derivative effect of the accountant-informant strategy is taxpayer uncertainty. Taxpayers cannot be certain whether or not their accountants are informants. While taxpayers face uncertainty, however, the Service does not. The service has inside information; it knows the identities of its stool pigeons. Economists call this imbalance of knowledge "asymmetric information."¹³²

While asymmetric information may deter conspiratorial relationships between accountants and clients, it may also create rifts among accountants because of its effect on the market for accountants.¹³³ Large, well-established accountancies will gain from the use of accountant-informants because such accountancies can implicitly warrant that their accountants are not informants. The implied warranty exists because a rational client would infer that the costs of a lost reputation and of potential liability at law to such an accountancy are undoubtedly greater than the paltry awards offered by the Service. Thus, it would not be in the interest of the firm or its members to serve as informants.¹³⁴

Sole practitioners are probably less capable of transmitting this signal. If, for the sole practitioner, the benefits from assisting the Service ever exceed the

¹³² See, e.g. PINDYCK & RUBINFELD, *supra* note 128, at 591-615; see also DENNIS W. CARLTON AND JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 716-17 (1990).

¹³³ The effect is to create a market for tax-accountant "lemons." See George A. Akerlof, *The Market for 'Lemons': Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970). Markets can be profoundly affected by asymmetric information. Unless a seller can somehow signal to a prospective buyer the quality of the product to be sold, a buyer who faces uncertainty about the quality of the product will rationally infer that the seller's willingness to sell the product evidences a price in excess of the product's value. The buyer will then lower the price at which he or she is willing to buy, and a self-fulfilling prophesy will occur: sellers with "high" quality products will leave the market in the belief that the market price for their product is too low, and only the "low" quality products will remain in the market. In the presence of uncertainty, bad products will drive out good. Ultimately the quality of all products in the market will be poor and the market price will fall to a commensurate level. Akerlof illustrated this process by reference to a market for used cars. In that example, the result of uncorrected asymmetric information was a market for "lemons."

¹³⁴ This analysis assumes, of course, that the value of "internal rewards to ratting" are negligible compared to the potential costs just described. It also assumes rationality, unity of interest between the individual accountant and the employing entity, and a few other things.

benefits of maintaining a professional reputation, it is likely that the balance tips in favor of cooperation only because the value of the reputation is exceedingly low. Reputation, however, is no more than an asset—goodwill—the value of which can be estimated by discounting future cash flow. By assumption, this cash flow will tend to be smaller with smaller accountancies. It will also be smaller when the accountancy is in financial distress or the accountancy does not have a perpetual existence—precisely the two problems afflicting the beleaguered Checkmate.¹³⁵ Presumably these situations are more likely to obtain with sole practitioners. Thus, given uncertainty, clients will have more reason to avoid sole practitioners.

That some accountants stand to gain by the use of accountant-informants, a situation which creates a wedge within the profession and precludes unified, strong lobbying efforts, is one reason to believe that Congress will not ban their use.¹³⁶ Another reason exists in the nature of collective action. As a general rule, large groups such as “the outraged public” are ineffective in lobbying Congress.¹³⁷ If action is to be undertaken, that action will come not

¹³⁵ See *supra* notes 3 and 13.

¹³⁶ The AICPA Tax Division has been studying the issue of whether the AICPA should seek a tax matters privilege. The matter has generated significant internal disagreement. In favor of seeking a privilege, it is argued that the confidences of clients are as important to accountants as they are to attorneys. It is also argued that without such privileges accountants are at a competitive disadvantage to attorneys competing for the same business. The last argument is unsound, for there is no attorney-client privilege when the attorney is serving in the capacity of an accountant rather than as a legal advisor. See, e.g., *Canaday v. United States*, 354 F.2d 849, 857 (8th Cir. 1966) (no privilege because attorney serving “merely as a scrivener”). In addition, the arguments against lobbying efforts are quite strong. First, opponents argue that precious resources should not be spent on such lobbying efforts when few clients have problems resulting from the lack of a privilege. Furthermore, the burden of proof in civil tax proceedings is on the taxpayer, making the privilege of still less practical value. Second, say opponents, the law relating to client privilege is complex and if the privilege were adopted CPAs would end up transferring money to lawyers for guidance in privilege matters. Finally, argue opponents, mistaken disclosures could increase malpractice claims against accountants. See Raby, *supra* note 2; see also James A. Woehlke, *Tax Currents*, THE TAX ADVISER, Feb. 1992, at 123.

¹³⁷ They are ineffective for three reasons:

First, the larger the group, the smaller the fraction of the total group benefit any person acting in the group interest receives, and the less adequate the reward for any group oriented action Second, since the larger the group, the smaller the share of the total benefit going to any individual, or to any (absolutely) small subset of members of the group, the less the likelihood that any small subset of the group, much less any single individual, will gain enough from getting the collective good to bear the burden of providing even a small amount of it Third, the larger the number of members in the group, the greater the organization costs.

from the demands of the general public, but from the demands of a special interest group composed of accountants.¹³⁸ As noted above, however, the interests of accountants are not necessarily unified in this matter, and any efforts at regulation would likely face strong opposition from the Internal Revenue Service, an entity that has found an extremely effective strategy for ensuring a steady flow of dollars to a Congress not averse to spending them.¹³⁹

Even if Congress will not frustrate the use of accountant-informants, there is another reason to doubt wide-scale use of the accountant-informant. As explained below, there is good reason to believe the supply of accountant-informants is limited.

B. Civil Liability and Practitioners' Licenses

No matter how shrewd the accountant-informant strategy from the viewpoint of the Service, the use of accountant-informants will always be constrained by the willingness of accountants to serve as informants.¹⁴⁰ In addition to professional disciplinary proceedings, a prime determinant of the effectiveness of this constraint is potential liability to the client at civil law. Accountant-informants might be sued on a number of theories, such as fraud, misrepresentation, or breach of fiduciary duty. Accountant-informants might find some defenses in misprision statutes, whistleblower statutes, the equitable defense of unclean hands, or perhaps even sovereign immunity. A detailed discussion of available theories and defenses, however, is unnecessary and beyond the scope of this Note. It need only be indicated that informants not only face uncertainty as to whether they can defend actions against themselves, but, regardless of ultimate liability, they also face the psychic and nonpsychic costs of litigation.

An interesting case illustrating the uncertainty faced by informants is *Wang v. Horio*.¹⁴¹ *Wang* involved a financial advisor named Horio who voluntarily

See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* 48 (2nd ed. 1971); see also *id.* at 22-33 (laying out mathematical framework supporting these propositions).

¹³⁸ The *Rook* case apparently prompted such action. See *supra* note 136; see also S.2452, 101st Cong., 2d Sess. (1990) (bill introduced by Senator Armstrong to amend the Federal Rules of Evidence to establish a tax preparer's privilege); S.1617, 102d Cong., 1st Sess. (1991) (bill introduced by Senators Symms and D'Amato to amend the tax code to provide protection for taxpayers).

¹³⁹ It is probably for this reason that neither the Armstrong nor the Symms/D'Amato initiatives have been successful. See *supra* note 138.

¹⁴⁰ This Note omits discussion of an additional consideration—the willingness of Internal Revenue Service agents to use accountant-informants even when authorized to do so. Presumably the Service incurs some agency costs resulting from the conflicting interests of its own employees.

¹⁴¹ *Wang v. Horio*, 741 F. Supp. 1373 (N.D. Cal. 1989), *rev'd and remanded in part*, *Wang v. United States*, 947 F.2d 1400 (9th Cir. 1991).

served as an informant to the Service in the belief that his employers, the Wangs, were hiding income.¹⁴² The Wangs were indicted, but the prosecutor dismissed the indictment when the court suppressed crucial evidence.¹⁴³ The Wangs then sued Horio on state and federal causes of action. Horio asked the Attorney General to certify under section 2679(d)(2) of Title 28 that he had acted within the course and scope of his employment as a government agent.¹⁴⁴ The Attorney General, however, refused such certification.¹⁴⁵ Horio then petitioned the court for such certification under section 2679(d)(3) of Title 28.¹⁴⁶ Fortunately for Horio, the lower court found that he was an employee of the United States because he was subject to the control of the Service. This finding extinguished several of the plaintiff's causes of action.¹⁴⁷ While the outcome may have seemed predetermined by Horio's classification as a "controlled" informant,¹⁴⁸ the refusal of the Attorney General to certify Horio as an employee still demonstrates the risk faced by informants. The ability of the Service to conveniently sever its links to informants is apparent from the reward application signed by Horio. The application recited that Horio "was

¹⁴² *Wang*, 741 F. Supp. at 1374.

¹⁴³ *Id.*

¹⁴⁴ Section 2679(d)(2) provides:

Upon certification by the Attorney General that the defendant employee was acting within the scope of his office or employment at the time of which the claim arose, any civil action or proceeding commenced upon such claim in a State court shall be removed without bond at any time before trial by the Attorney General to the district court of the United States for the district and division embracing the place in which the action or proceeding is pending. *Such action shall be deemed to be an action or proceeding brought against the United States* under the provisions of this title and all references thereto, *and the United States shall be substituted as the party defendant.* This certification of the Attorney General shall conclusively establish scope of office or employment for purposes of removal.

(emphasis added).

¹⁴⁵ *Wang*, 741 F. Supp. at 1375.

¹⁴⁶ Section 2679(d)(3) provides in part:

In the event that the Attorney General has refused to certify the scope of office or employment under this section, the employee may at any time before trial petition the court to find and certify that the employee was acting within the scope of his office or employment. Upon such certification by the court, such action or proceeding shall be deemed to be an action or proceeding brought against the United States under the provisions of this title and all references thereto, and the United States shall be substituted as the party defendant.

28 U.S.C. § 2679(d)(3) (1988).

¹⁴⁷ *Wang*, 741 F. Supp. at 1379.

¹⁴⁸ *Id.* at 1378.

not an employee of the Department of Treasury at the time [he] came into possession of the information or at the time [he] divulged it."¹⁴⁹

As suggested earlier, in addition to potential liability and the costs of defending suits, accountants considering service as informants must consider the possibility of professional discipline. Such was the situation with Checkmate,¹⁵⁰ who lost his license to practice in Missouri. A professional license is the most valuable asset owned by the typical practitioner, and the risk of losing it undoubtedly prevents many accountants from serving as informants. The value of a license, however, varies with the accountant's age and the success of the accountant's practice. For an accountant in Checkmate's position, a septuagenarian twenty thousand dollars in debt to the federal government,¹⁵¹ this asset promised little future cash flow. Consequently, for Checkmate the potential cost of losing the license was minimal compared to the benefits of cooperating with the Service. Few accountants, however, will find themselves situated in such a precarious position. Thus, the frequency of Checkmate-type incidents should not be overestimated.

VI. SUMMARY AND CONCLUSION

This Note set out to explore the use of accountant-informants and to look beyond the media hype surrounding that use. It has suggested that the law of accountant-client privilege is irrelevant in federal, and perhaps even state, criminal tax prosecutions, but that clients duped by their accountants might occasionally find refuge in the Fourth Amendment, particularly if the accountant was retained for purposes far removed from public reporting. In most cases, however, a Fourth Amendment defense will be tenuous, and other havens suggested by the defense bar are unavailable. The absence of defenses, however, should not alarm honest taxpayers. The number of accountant-informants is unlikely to surge. A game theory-based understanding of the use of accountant-informants suggests that the Service need only occasionally resort to their services to further its goal of deterring noncompliance. Moreover, the benefits of serving as an informant will likely pale beside the actual and potential costs of doing so. Therefore, the Service will seldom find accountants willing to serve as informants.

Thus, despite adverse publicity surrounding the use of an accountant-informant in the *Rook* case, the enforcement division of the Internal Revenue Service remains a powerful force. In fact, the adverse publicity strengthened

¹⁴⁹ *Id.*

¹⁵⁰ See Geyelan and Pollack, *supra* note 12.

¹⁵¹ See *supra* notes 3, 13.

the Internal Revenue Service: stories involving accountant-informants are good "bad press."

Charles Q. Jakob